DURHAM

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CITY OF MEDICINE

CITY OF DURHAM | NORTH CAROLINA

Date: **December 7, 2011**

To: **Thomas J. Bonfield, City Manager**
Through: **Keith Chadwell, Deputy City Manager**
From: **Reginald J. Johnson, Interim Director**
Department of Community Development
Subject: **Rebuild Durham, Inc. Rental Project Restructuring**

Executive Summary

Rebuild Durham, Inc. (RDI) currently owns and manages 13 single-family homes which were purchased and rehabilitated between 2000 and 2007 with HUD Home Investment Partnership (HOME) loan funds from the City of Durham. In accordance with HOME regulations, the properties were to be occupied by and remain affordable to households with incomes at or below 60% of the area median, for a period of not less than 15 years. Under the HOME regulations, failure to comply with the occupancy requirement during the period of affordability triggers, as in this case, a HUD repayment which is based on the HOME funds invested prorated over the 15 year period.

Currently, five of the 13 properties owned by RDI are vacant and not suitable for occupancy. Deficiencies in some of the occupied properties have also been identified. Consequently, the City of Durham is required to repay HUD approximately $208,000.00 in non-federal funds.

Recommendation

The Department of Community Development recommends that City Council adopt the FY 2011-2012 General Capital Improvement Project Ordinance superseding Grant Project Ordinance #14139, and authorize the expenditure of approximately $208,000.000 in housing bond program income in the form of a reimbursement to the U.S. Department of Housing and Urban Development and authorize the City Manager to execute a contract with Rebuild Durham, Inc. to restructure its rental program.

Background

In June of 1998 City Council approved The Plan to Eliminate Substandard Housing. The Plan included the creation of a nonprofit agency that would acquire and rehabilitate abandoned or deteriorated single family homes to provide permanent rental housing for low income households. RDI came into being as a result of collaboration between The Campaign for Decent Housing, an organization of non-profit housing providers, and the Department of Housing and Community Development. The new Board included representatives from each of the four district PACs, and representatives of the legal profession, private property management, and banking.

On August 3, 2000 the City executed two HOME-funded agreements.

- The first provided a revolving fund of $460,000 from which RDI could draw $70,000 per property to purchase and rehabilitate a total of twelve properties over the following two years. After each property received its Certificate of Compliance from the Inspections Department, RDI was to secure a first mortgage for $35,000 and pay that amount to the City to reduce the HOME investment. Rents were initially capped at 30% of the tenants' annual household income.

- The second provided an operating grant of $47,700 to cover start-up expenses for the new agency.

At the time, RDI's business plan was to finish 12 properties in two years, to add 15 more properties in the third year, and to engage a professional property management firm to manage the completed units. But at the end of the second year only eight units were completed and occupied, and rental income was not covering operating costs. The City extended the term date of the loan contract to August 2005.

In August of 2003, the City's Finance Department issued a policy change that required a separate loan for each property. The revolving fund was broken up and an additional $350,000 was added by an amendment to the loan agreement in order for this program to be in compliance with the new guidelines. The amendment added a 13th unit to the goals, but all other terms and conditions of the original contract remained in effect. RDI had not yet created enough rental income to be self-sustaining, so the City provided an additional operating grant in the amount of $38,000.

By August of 2005 RDI had completed their 12th unit, but the Executive Director resigned. In the absence of paid staff, RDI board members kept the properties occupied and all tenant records in compliance with HOME requirements, but production stalled.

A new Executive Director came on board in 2006. A second amendment to the year-2000 loan agreement was executed to relieve RDI of the rent caps of 30% of tenant household income. Rents were allowed to rise to HUD's Low Home Rent levels.

In March of 2007 the City invited RDI to participate in an extensive, HUD-sponsored, capacity-building training for CHDOs (Community Housing Development Organizations). Another operating grant was executed in April of 2007 for $24,000, bringing the total operating subsidies to $129,700. In addition, a loan of $138,000 was executed in order to fund the acquisition and rehabilitation of additional properties.

The 13th property – a part of the year-2000 loan agreement - was completed and occupied in July of 2007. The 2007 operating grant of $24,000 was spent while the 13th property was completed and occupied, but the year-2007 acquisition/rehab loan was not utilized. Moreover, Property inspections revealed minor code violations on several properties, and the annual monitoring visit revealed some compliance issues in the tenant record keeping.

RDI lost their Executive Director in 2008, and although the term date on the 2007 loan of $138,000 was extended, no additional properties were ever acquired and the loan eventually expired.

In the absence of paid staff, the RDI board members again acted to maintain the properties and the tenant files, but City monitoring visits and housing code inspections revealed increasing incidences of noncompliance. DCD senior staff met several times with RDI leadership and finally in December of 2009 met with their Board as a whole to discuss RDI's two remaining options: sell the properties or hire the property manager. After nearly a year of reviewing property management proposals and considering their options, RDI notified DCD in November of 2010 that they had hired a new, part-time Executive Director who had a realtor's license.

Since the arrival of the new Executive Director, City staff has provided extensive technical assistance. The tenant file documentation has been improving, but the properties are deteriorating. All 13 properties currently have multiple housing code violations. Five are vacant and uninhabitable.

In August of 2011, the Department of Community Development (DCD) scheduled a consultation with HUD to assess options for dealing with RDI's non-compliance. Based on a review of the records and an exterior inspection of the vacant units, it was apparent to HUD staff that the project failed to meet the requirements of the affordability period and they recommended that the City consider its options for remedy. DCD determined that it was not feasible to rehabilitate the units. The other options included substitution of comparable non-federally-assisted units or withdrawing the HOME investment and paying back that portion of the investment for which the period of affordability requirements were not met. The City does not have the appropriate units to meet the substitution provision.

Issues and Analysis
Twelve of the 13 properties owned by RDI have first mortgages held by SunTrust. Only 110 Chestnut Street, which is located in the Southside project area, is not subject to a first mortgage.

This contract with RDI to restructure its rental program is necessary to extract all HOME requirements from RDI properties, as a cure for the non-compliance which currently exists. The contract involves the release of all restrictive covenants, the release of all deeds of trust and the forgiveness of all remaining loan balances. These actions will provide RDI with maximum flexibility in determining the future disposition of its portfolio. RDI may consider, for example, selling some of the properties to generate income which can be reinvested in other of its properties.

The contract also requires RDI to deed the 110 Chestnut Street property to another non-profit, acceptable to the City.

To assist RDI in sustaining itself until the restructuring has been completed, the Department will provide it with an $8,000.00 emergency operating grant from the housing bond program income.

Once the HOME funds are returned to HUD, the City will request a waiver from HUD which would allow the funds, repaid by the City to be restored to the City's HOME account. HUD officials in Greensboro have indicated that they would look favorably upon such a request.

Alternatives
HUD has been aware of RDI's struggles with compliance for the past several years and the City's efforts to provide assistance. The proposed payback to HUD and RDI's program restructuring are voluntary actions by the City with HUD's knowledge. Should these voluntary actions not be taken, HUD would ultimately issue a formal request for the payback of the HOME investment.

In terms of other courses of action, the Department of Community Development did consider providing funds to RDI to rehabilitate its portfolio. However, such an investment would be a short term fix to current physical deficiencies and would not address the longer terms issues of file compliance and the sustainability of an organization dependent on rental income from only 13 properties.

Financial Impact
Housing bond program income is available as the payback source. As noted previously, the City will request that the payback amount be returned to its HOME account.

SDBE Summary
Not applicable to this item.